

(2004) 05 KAR CK 0019

In the Karnataka High Court

Case No : Regular First Appeal No. 200 of 1998

Syndicate Bank

APPELLANT

Vs

Mahalaxmi Ginning Factory and Others

RESPONDENT

Date of Decision : 28-05-2004

Acts Referred:

Banking (Regulation) Act, 1949 — Section 21 A
Civil Procedure Code, 1908 (CPC) — Order 34 Rule 11, 34, 96

Citation : AIR 2005 Kar 5 : (2005) 2 BC 230 : (2004) 122 CompCas 58 : (2004) 3 KCCR 1983

Hon'ble Judges : R.V. Raveendran, J;K.L. Manjunath, J

Bench : Division Bench

Advocate : Tukaram S. Pai, for the Appellant; S.M. Chandrasekhar, for Respondents-1 to 6 and 7(A), for the Respondent

Judgement

1. Appellant herein filed O.S. No. 57 of 1996, on the file of Civil Judge (Senior Division), Saundatti [Old O.S. No. 60 of 1993, on the file of Principal Civil Judge, Bailhongal] against the first respondent-firm and its four partners (respondents 2 to 5) and two sureties (respondents 6 and 7). The appellant and first respondent will also be referred to as the "Bank" and "borrower firm". Respondents 1 to 5 together will also be referred to as the "Borrowers" and respondents 6 and 7 as the "guarantors".

2. The plaint averments, in brief, were as under:

2.1 Appellant-Bank sanctioned a term loan of Rs. 6,37,000/- to the first respondent-firm (and its partners-respondents 2 to 5) for construction of a ginning factory and purchase of machineries. Out of sanctioned loan, the borrowers availed in all Rs. 6,11,000/- (that is Rs. 1,00,000/- on 31-10-1984, Rs. 1,00,000/- on 13-11-1984, Rs. 2,04,743/- on 23-11-1984, Rs. 40,600/- on 18-12-1984, Rs. 50,000/- on 28-12-1984, Rs. 25,000/- on 11-6-1985 and Rs. 90,657/- on 19-9-1985). The borrowers and the sureties executed a term loan-cum-hypothecation agreement dated 31-10-1984 in favour of the Bank agreeing

to repay the loan in agreed instalments with interest at the rate of 2.5% above the RBI rate of interest subject to a minimum of 12.5% p.a., on 31st March, 30th June, 30th September and 31st December of every year so long as the principal or any part thereof remained unpaid. Under the said agreement they agreed that in default of payment of any instalments or interest, the entire loan amount shall become due without reference to further instalments; that they will pay the overdue interest at the rate stipulated by the Bank, if they failed to pay the loan amount or the interest on the due dates; and that they would pay interest at the rates varied from time to time in accordance with RBI directions until the dues were fully cleared. Under the said agreement, they hypothecated four items of machinery (described in plaint "B" schedule) as security for repayment of the loan. They executed a letter dated 31-10-1984 undertaking to pay overdue interest at the rate of two per cent in the event of default and waiving notice of variation in the interest rates as per RBI directions.

2.2 The Bank alleged that the borrowers and sureties agreed that the Bank is at liberty to "compound quarterly interest". They further alleged that the respondents 3 and 4 mortgaged their land bearing Sy. No. 37, measuring 2 acres 1 gunta, situated at Saundatti (plaint "A" schedule property) as security for payment of the loan, by way of mortgage by deposit of title deeds on 29-10-1984, confirmed by a subsequent letter dated 29-10-1984.

2.3 The particulars of the amounts advanced, particulars of debits on account of interest, Credit Guarantee Commission fees, insurance premia and other miscellaneous debits and all payments made by the borrowers were shown in Loan Account No. OSL/SSI/47/1984, maintained regularly in the course of Bank's business. An extract of the said loan account duly certified under the Bankers' Books Evidence Act, 1891 was produced as an annexure to the plaint. As per the said account, a sum of Rs. 7,32,089/- was due from the respondents as on 22-9-1993 (date of suit).

2.4 The Bank therefore prayed for a decree for the said sum of Rs. 7,32,089/- with interest at the rate of 21.5% p.a. compounded with quarterly rests from the date of suit till realisation. The plaintiff also sought a preliminary decree for the sale of mortgaged and hypothecated properties described in the schedules to the plaint with consequential reliefs.

3. Respondents 1 to 5 filed a written statement and respondents 6 and 7 filed a separate written statement, raising the following among other contentions:

(i) There was no agreement to pay compound interest and therefore the Bank could not charge compound interest.

(ii) Whenever there were revisions in the RBI rate of interest, the Bank nether informed the borrowers about such revision in the RBI rate nor obtained their consent for the revision. Therefore the Bank was not entitled to increased/ revised rates of interest.

(iii) The Bank was not entitled to overdue interest.

(iv) The Bank had made several unauthorised debits in the loan Account like credit guarantee commission fee, interest on interest, insurance premia, valuation charges, legal charges etc., and those have to be deleted.

(v) As per the directions of RBI, small-scale industries like the borrowers firm were entitled to several benefits. The Bank had to extend the said concessions and benefits to the borrowers.

(vi) The statement of account produced by the Bank showing Rs. 7,32,089/- as due by them was erroneous and excessive. As per the statement (calculation sheets) prepared by the borrower (showing the amounts advanced, simple interest at the contract rate and the amounts repaid), the amount due was only Rs. 2,25,369.06 ps. Though the said Account Statement was furnished to the Bank, with a request to rectify the Bank's account (by several letters, the last of which was written on 19-9-1993), the Bank failed to rectify the same.

Respondents 6 and 7 raised several additional grounds. They submitted that the loan was guaranteed by the Deposit Insurance and Credit Guarantee Corporation ("DICGC" for short), under the Small Loans [Small-Scale Industries] Guaranteed Scheme, 1981 and as DICGC would pay 75% of the defaulted loan amount, their liability should be restricted to only 25% of the defaulted loan amount.

4. On the said pleadings, the Trial Court framed the following issues on 20-2-1995 :

(1) Whether the plaintiff-Bank proves that the present Manager of the Bank V.V. Kadapikar is duly authorised under a power of attorney to file the present suit for and on behalf of plaintiff-Bank?

(2) Whether the plaintiff-Bank further proves that the defendants had agreed to pay an interest at the rate of 12.5% p.a. to be compounded quarterly and had further agreed to pay penal interest at 2% p.a. over the agreed rate in case of default and the defendants-Executed agreement accordingly?

(3) Whether the plaintiff-Bank proves that the account extract produced by it, is correct and proper?

(4) Whether the plaintiff-Bank further proves that the defendants have acknowledge the debt on 5-10-1987 and on 24-9-1990 by executing A.O.D.?

(5) Whether the plaintiff-Bank suit is barred by law of limitation?

(6) Whether the defendants prove that they have credited in all an amount of Rs. 9,20,766.82 ps. regularly upto 3-9-1993 and the balance of loan is only to the extent of Rs. 2,87,520/-?

(7) Whether the defendants prove that in the alternative they are entitled for an yearly instalments of Rs. 15,000/- for the repayment of the balance of loan?

(8) Whether the plaintiff-Bank is entitled for a decree? If so for what amount?

The Trial Court also framed the following additional issues on 12-9-1996:

1. Whether defendants 5 and 6 prove that the plaintiff has committed breach of terms and conditions of contract by providing inadequate working capital to defendant 1?

2. Whether the plaintiff is entitled to recover service charges, credit guarantee charges, legal fees and insurance premium amount etc., debited in account extract?

3. Whether defendants 5 and 6 prove that the signatures were obtained on blank and semi-filled loan documents by practising fraud and misrepresentation?

4. Whether defendants 5 and 6 prove about plaintiff by invoking the guarantee cover received 60% suit amount from DICGC?

5. Whether the suit of the plaintiff is bad for non-joinder of DICGC?

5. The Bank examined its Manager during 1984-86 and the Manager during 1993-95 as P.W. 1 and P.W. 2 and marked Exs. P. 1 to P. 16. On behalf of the defendants, third defendant (fourth respondent herein) was examined D.W. 2. One Vidyadhara who had prepared the computerised statement showing the amount due according to defendants was examined as D.W. 1. The computerised account statement prepared by the defendants through D.W. 1 (by charging simple interest at a flat rate of 12.5% p.a.) showing the amount due by them as only Rs. 2,25,369.06 and a statement showing the amount as claimed by the Bank, were exhibited as Exs. D. 1 and D. 2. After appreciating the evidence, the Trial Court by judgment and decree dated 19-1-1998, decreed the suit in part. It answered Issues (1) and (4) in the affirmative; and Issues (3), (5), (7) and additional Issues 1, 3, 4 and 5 in the negative. It answered Issue 2 by holding that the plaintiff had proved that the defendants had agreed to pay interest at the rate of 12.5% p.a. The total interest (simple interest at 12.5% p.a.) due was determined as Rs. 5,10,035.88 accepting the calculation sheets produced by respondents as Exs. P. D1 and P. D. 2. It answered Issue 6 by holding that the defendants had established that they had credited in all Rs. 9,20,766.82 upto 3-9-1993, by relying on the credit entries in the Statement of Account (Ex. P. 14) produced by the Bank. The Trial Court answered the additional Issue 2 by holding that the plaintiff is entitled to recover only insurance premia (Rs. 25,100/-), valuation charge (Rs. 517/-) and notice charges (Rs. 150/-) in addition to the principal and interest. As a consequence, the Trial Court arrived at the amount for which the suit was to be decreed as follows.-

-----				Sl.
Description	Amount	No.	(In	Rupees)
-----				1.
Amount advanced (as per Bank's statement 6,11,000.00 of account Ex. P. 14)				
-----				2.

Simple interest at 12.5% p.a. (as detailed 5,10,036.88 in Ex. D. 1 prepared by respondents)

-----		3.
Insurance	premia	25,100.00
-----		4.
Valuation	charges	517.00
-----		5. Notice
charges		150.00
-----		Total
11,46,802.88		
-----		Less
Amount credited by the borrowers from 9,20,766.82 time to time (as per Ex. P. 14)		-----
Balance	due	2,26,036.06

Thus, the suit was decreed for Rs. 2,26,036.06 with simple interest at the rate of 12.5% p.a. from the date of suit till date of realisation. The Trial Court granted six months' time to the defendants to pay the decretal amount and reserved liberty to the Bank to apply for final decree for sale of the mortgaged property and the hypothecated machinery if payment was not made within the period stipulated. The Trial Court also directed that shortfall if any shall be recovered from the respondents personally. The Court awarded proportionate costs to the Bank and directed drawing up of a preliminary decree on the above terms. The borrowers paid Rs. 3,66,155.06 on 27-2-1998 as per the decree.

6. Feeling aggrieved by the rejection of claim for compound interest with quarterly rests and non-grant of interest at the rates varied from time to time as per RBI directives and deletion of certain expenses debited to the account, the Bank filed this appeal u/s 96 of the Code of Civil Procedure. On the grounds urged, the following points arise for our consideration in this appeal:

(a) Whether the plaintiff-Bank was entitled to revised rates of interest, as per Reserve Bank of India directives and whether the Court below erred in granting interest at a flat rate of 12.5% p.a?

(b) Whether the Trial Court erred in granting simple interest instead of compound interest with quarterly rests?

(c) Whether the Trial Court erred in rejecting the claim for overdue interest at 2% p.a. in addition to the normal interest?

(d) Whether the Trial Court committed an error in disallowing the debits relating credit guarantee commission fees and services charges (xerox copy charges, legal expenses etc.)?

(e) To what amount is the Bank is entitled?

7. Before considering the said questions, we may refer to the nature of claim and

the evidence. The amount claimed is due in regard to a term loan granted to a small-scale industry for construction of a ginning factory building and for purchase of machinery, secured by the mortgage of immovable property and hypothecation of certain machinery. The frame of the suit is a mortgage suit for sale. The prayer in the plaint is recovery of a sum of Rs. 7,12,089/- with interest at the rate of 21.5% p. a. to be compounded with quarterly rests, to be recovered by way of sale of mortgaged and hypothecated properties.

8. The Bank marked the term loan agreement dated 31-10-1984 as Ex. P. 8. Clauses 3 and 4 are the only clauses relating to interest. They are extracted below:

"3. In consideration of the sum of Rs. 6,37,000/- to be lent by the Bank as mentioned in the First Schedule hereto, the borrowers hereby confirm/s having agreed to repay to the Bank the principal sum of Rs. 6,37,000/- in instalments on the dates mentioned in the Second Schedule hereto; The borrower/s agree/agrees that interest on the said principal sum of Rs. 6,37,000/- or on so much thereof as shall from time to time remain unpaid shall be repayable at the rate of 4% per annum above the Reserve Bank of India rate subject to the minimum of 14% per annum on the 31st March, 30th June, 30th September and 31st December each year and also so long as the principal or part thereof remain unpaid.

4. The borrower/s agree/agrees that if quarterly interest and/or any other instalment on due date is not paid, the arrears in the loan shall bear overdue interest at the rate fixed by the Bank for such loans from time to time until the interest and/or the instalment of the principal in arrears as the case may be are paid".

The schedule to the term loan agreement (Ex. P. 8) required the loan amount to be repaid in the following instalments;

-----	(i)	16
instalments Rs. 11,390/- each from 31-3-1985 to 31-8-1985, from 31-1-1986 to 31-8-1986, from 31-1-1987 to 28-2-1987	Rs. 1,82,240/-	-----
-----	(ii)	29
instalments of Rs. 14,250/- each from 31-3-1987 to 31-8-1987, from 31-1-1988 to 31-8-1988, from 31-1-1989 to 31-8-1989, Rs. 4,13,250/- from 31-1-1990	to	31-7-1990
-----	(iii)	One
instalment of Rs. 15,510/-	Rs. 15,510/-	on 31-8-1990
-----	Total	-----
Rs.		6,11,000/-
-----		-----

9. The borrowers also executed a letter undertaking dated 31-10-1984 (Ex. P. 9), agreeing to pay overdue interest at the rate of 2% p. a. or such other rate as may be charged by the Bank from time to time on the amount overdue in case of

default. By the said letter, the borrowers also waived the notice of variation of rate of interest (as per RBI directives) to be issued by the Bank and agreed that such variations in the rates of interest notified in the Notice Board of the Bank shall be sufficient notice and they will pay the interest at the rates so notified.

10. The Manager of the Bank (at the time of sanction and release of the loan) was examined as P.W. 1. He stated that the rate of interest agreed at the time of sanctioning the loan was 12.5% p.a. He further stated that the defendants had agreed to pay compound interest as per the directions issued by the RBI from time to time and had also agreed to pay overdue interest at the rate of 2% per annum in the event of their committing any default in repayment of loan availed by them, In his cross-examination, P.W. 1 reiterated that what was stated in the plaint (regarding interest) and Clause 3 of the agreement were true and correct. P.W. 2 (who was the Manager of the Bank between 1993 to 1995) admitted that the borrower firm was a Small Scale Industrial Unit (SSI Unit) and that Reserve Bank of India had issued circulars from time to time varying the rates of interest.

Re: Point (a).--

11. In the plaint, the Bank has stated that the contract provided for payment of interest at the rate of 2.5% above RBI rate subject to a minimum of 12.5% pa., on 31st March, 30th June, 30th September and 31st December of each year. The plaint further avers:

"They agreed that they will pay interest at varied rates from time to time as per the RBI directions until dues are cleared in full.. .".

But, the Bank neither disclosed the rates of interest charged from time to time nor the dates from which the interest rate was revised. The plaint did not even contain an averment that the Bank had revised the interest from time to time and that such revisions were in accordance with RBI directives, nor an averment that the Bank had notified the revised rate of interest to the borrowers or guarantors, whenever the interest rate was revised. In the prayer column, the Bank mentioned that it is entitled to interest from the date of suit till date of realisation at the rate of 21.5% p.a.

12. The certified statement of account, which was produced with the plaint (Ex. P. 14) though showed the amounts debited to the account as interest from time to time, did not disclose the rate or interest. The learned Counsel for the Bank however submitted that a statement of account showing the rates of interest charged had been filed before the Trial Court (not marked) showing that interest had been charged at the following rates:

Rate	of	Interest	Period (p.a.)
31-10-1984	to	31-12-1985	12.5%

1-1-1986	to	31-3-1990	15%

1-4-1990	to	30-9-1992	18%

1-10-1992	to	21-9-1993	24.5%

The statement of account (Ex. P. 14) also showed that interest was being debited once in a quarter upto September 1992. Thereafter a lump sum of Rs. 1,58,965-00 was debited on 21-9-1993 after an interval of one year. The statement of account also shows that in addition to interest that was being debited regularly every quarter, the Bank had additionally debited the following lump sums towards interest:

-----						Date
Description	of				entry	Amount

18-12-1992	`To normal rate of Rs. 85,919-40 interest charged from 1-11-1990 to					30-6-1992"

13-2-1993	`To difference of Rs. 9,882-00				interest"	

The above debits were not explained by the Bank either in the plaint or in the evidence.

13. The Bank has taken a specific stand both in the plaint and in the evidence, that it is entitled to revise the rate of interest, as and when RBI revises the interest rates. The Statement of Account showing the actual debits regarding interest was annexed to the plaint. Clause 3 of the term loan agreement (Ex. P. 8) also supports the said claim as it links the rate of interest payable by the borrowers to the RBI rate. But, the Bank did not state the different rates of interest charged during different periods with reference to the revision of RBI rates, either in the plaint or in the evidence. The Supreme Court has held that the RBI Circulars regarding interest to be charged have statutory force (vide Corporation Bank Vs. D.S. Gowda and Another, and Central Bank of India Vs. Ravindra and Others, . Therefore, even though there is no specific plea or evidence in regard to rates of interest charged from time to time, the rates of interest can be determined on the basis of RBI circulars produced during hearing. A perusal of the RBI circulars shows that RBI has prescribed the interest rates for several types of loans and the rate prescribed for "Term loans to SSI units (above Rs. 2 lakhs)" will be applicable to the case on hand.

14. At this juncture, we should however refer to a variance between pleadings and evidence. The plaint makes a categorical statement that the agreed rate of interest is 2.5% over and above the RBI rate, subject to a minimum of 12.5% p.a. P.W. 1, who is the manager of the plaintiff-Bank, states in his evidence that

the said statement is correct and also states that the sanctioning of loan was subject to the condition that the interest will be at 12.5% p.a. This would mean that the agreed rate was 2.5% p.a. over the RBI minimum rate which at the relevant time appears to be 10%. In fact, the term loan agreement (Ex: P. 8) states that the RBI rate at the relevant time was 10% p.a. But Clause 3 of the term loan agreement states that the defendants had agreed to pay interest at the rate of 4% p.a. over and above the RBI rate, subject to a minimum of 14% p.a. This contradiction between the plaint and the oral evidence of plaintiff (stating that the rate is 12.5% p. a.) on the one hand and the documentary evidence [term loan agreement stating that interest rate is 14% p.a.] on the other, is a serious discrepancy. If the question was as to whether the oral evidence should be accepted or documentary evidence should be accepted, we could have easily preferred the documentary evidence. But, in this case, the plaint specifically pleads that the defendants agreed to pay the interest at the rate of 2.5% over and above the RBI rates subject to a minimum of 12.5% p.a. In view of the categorical claim in the plaint read with the oral evidence of P.W. 1 (the manager of the Bank), it has to be taken that the borrowers had agreed to pay interest at 2.5% over and above the RBI rate of 10%. The provision in the term loan agreement that the interest payable is 4% over and above the RBI rate, will have to be ignored, having regard to the specific plea in the plaint and the oral evidence of the manager of the Bank. No amount of evidence, on a plea that is not put forward can be looked into. In fact, the rate of interest that is debited in the statement of account (Ex. P. 14) is 12.5% p.a. upto the end of December 1985.

15. The Trial Court has held that the Bank is not entitled to revise the rate of interest as per on RBI directives as such increases were not notified to the borrower. For this purpose, the Trial Court has relied on the decision of this Court in *Syndicate Bank Vs. R. Veeranna and others*, . But, the Trial Court failed to notice that the borrowers had specifically waived the need for any notice whenever there was variations in the rates of interest (as per letter dated 31-10-1984 marked Ex. P. 9) and had agreed that the Bank will be entitled to revise the rates of interest as per RBI rate from time to time without notice. Further, the decision in *R. Veeranna's case*, supra, relied on by the Trial Court is now reversed by the Supreme Court in *Syndicate Bank Vs. R. Veeranna and Others*, . The Supreme Court has held that if the agreement makes express provision for revision of rate of interest, the Bank need not put the borrower on notice before charging higher rate, on the basis of such agreement. Therefore, the Bank is entitled to unilaterally increase the rate of interest whenever RBI revises the minimum rate of interest, if the contract provides for such revision.

16. If the Reserve Bank of India prescribed the minimum lending rate, and there is a contract for payment of a particular percentage over the minimum rate, the Bank will be entitled to interest accordingly, subject to the maximum rate, if any prescribed on RBI. (For example, if the RBI minimum rate was 10% and the borrower agrees to pay 4% over the RBI rate, the rate of interest payable will be

14% p.a.; and if RBI revises the minimum rate as 14% then the rate of interest payable will be 18% p.a. But if RBI had specified the maximum rate say as 16% p.a., then the rate of interest that could be charged would be 16% p. a. and not 18% p.a.). Having regard to the terms of the contract, in this case the Bank is entitled to charge 2.5% p.a. over, and above the RBI rate. As RBI rate during 1984 is stated to be 10%, the Bank was entitled to charge 12.5% p.a. When the RBI fixed the rates of interest instead of minimum rates, then the Bank was entitled to interest at such fixed rate. Having regard to the RBI circulars that were in force from time to time, the terms of contract, and the interest tax applicable, the rates of interest which the Bank is entitled to charge in the case of the borrowers, were as follows (term loans to SSI Units in excess of Rs. 2 Lakhs):

CIRCULAR	PERIOD	RATE	OF	DATE	INTEREST	RBI (P.A.)
(31-10-1984 to 31-3-1987)	12.5%	31-03-1987	01-04-1987	to 09-10-1988	12.5%	08-10-1988
10-10-1988 to 21-09-1990	12.5%	21-09-1990	22-09-1990	to 12-04-1991	18%	12-04-1991
03-04-1991 to 03-07-1991	19%	04-07-1991	04-07-1991	to 08-10-1991	20%	08-10-1991
09-10-1991 to 01-03-1992	22.25%	29-02-1992	02-03-1992	to 08-10-1992	21.25%	08-10-1992
09-10-1992 to 29-02-1993	21.25%	27-02-1993	01-03-1993	to 23-06-1993	20.25%	23-06-1993
24-06-1993 to 01-09-1993	19.25%	01-09-1993	From 02-09-1993		18.25%	

Re: Point (b).--

17. The next question that arises for our consideration is whether the plaintiff-Bank is entitled to only simple interest or whether it is entitled to compound interest with quarterly rests. The plaint avers that the defendants had agreed that the Bank is at liberty "to compound quarterly interest". P.W. 1 (Bank Manager) - also stated that: "The defendants also agreed to pay compounded rate of interest". He denied the suggestion that the loan agreement executed by the defendants did not authorise charging of compound rate of interest. On the other hand, the defendants have specifically denied any agreement to pay compound interest, both in their written statement and in the evidence. Therefore, the first question is whether there was any contract to pay compound interest.

18. The letter of sanction would have shed some light on this question. But, the same is not produced. The only document that is relied on by the Bank in this behalf is the term loan-cum-hypothecation agreement (Ex. P. 8) dated 31-10-1984. We have already extracted Clause 3 of the said agreement in para 8 above, Significantly, it does not authorise charging of compound interest. Nor does it state that the Bank will be entitled to charge the interest with quarterly rests or yearly rests or monthly rests, which, in banking parlance, mean charging

of compound interest, by capitalising the interest at the end of a quarter or year or month. All that Clause 3 states that the borrower has agreed to pay the interest on 31st March, 30th June, 30th September and 31st December of each year. A provision in the agreement that interest should be paid at the end of each quarter of the year does not mean that the borrower have agreed to pay the compound interest or that the Bank is entitled to charge compound interest, with quarterly rests. To reiterate, an agreement to pay interest quarterly is not an agreement to pay interest with quarterly rests. If the contract intended to provide for charging of compound interest, the agreement would have further provided that if the borrowers failed to pay the interest on 31st March, 30th June, 30th September and 31st December of each year, the Bank could debit interest to the loan account and interest so debited will form part of the principal for the purpose of levy of further interest. On the other hand, the term loan agreement makes a clear distinction between the interest and the principal and does not provide for interest being added to the principal for the purpose of charging further interest. No other document was executed by the borrowers or sureties regarding interest. The Supreme Court had categorically held that where there is a contract between the Bank and the borrower providing for and governing the interest payable and such contract does not provide for "compound interest" or "interest with periodical rests", then the Bank will not be entitled to compound interest (vide *State Bank of India, Bhubaneswar Vs. Ganjam District Tractor Owners' Association and Others*,). As there is no contract to pay compound interest or to capitalise interest, the Bank is not entitled to charge compound interest.

19. The Bank however contends that even though there is no specific contract for payment of interest with quarterly rests, it is entitled to charge interest with quarterly rests (that is debit the accrued interest to the account of the borrower at the end of every quarter so that it is capitalised and becomes part of principal for purposes of charging interest for the next quarter) for three reasons:

- (i) The RBI Circulars permit charging of interest with quarterly rests.
- (ii) The Universal custom of Bankers is to charge compound interest.
- (iii) The borrowers did not protest, but acquiesced to the debiting of interest with quarterly rests.

The Bank strongly relied on the decision of a Division Bench of this Court in *Jayakunvar Manilal Shah Vs. Syndicate Bank*, which while construing the very clause with which we are concerned (i.e., Clause 3 of the term loan agreement) held that the said clause enabled the Bank to claim compound interest with quarterly rests. The Division Bench held thus:

"The word "compound interest" has also been explained in the Law Lexicon i.e., compound interest is interest upon interest where accrued interest is added to

the principal sum and the whole amount treated as a new principal for the calculation of the interest for the next period.

In the case on hand, Ex. P. 2 does not use the term "rest". It only states that the interest is payable at the end of each quarter by giving the last date of each quarter of the year.

Therefore we are now to see whether, in the absence of the term "rest", Clause 3 of Ex. P. 2 would amount to agreeing for quarterly rest. As per the Reserve Bank of India Circular referred to above, there is no doubt that a commercial Bank like that of the plaintiff, is entitled to levy and recover interest at quarterly rest, The term "rest" as explained above, means adding of interest at the end of the rest period to the principal and from that date onwards it would become part of the principal and the Bank can claim interest on it just as principal or as part of the principal sum. Clause 3 of Ex. P. 2 clearly states that the interest is payable at the end of each quarter and in the event it is not paid at the end of each quarter, the amount shall bear overdue interest at the rate fixed by the Bank. Therefore, the plaintiff-Bank has maintained the accounts by, indicating the quarterly rest and it has calculated interest at the end of the quarter and has added it to the principal. Defendant 1 has never raised any objection in this regard. Therefore, it follows that defendant 1 has also understood the words used in Clause 3 of Ex. P. 2 referred to above that the interest payable at the end of each quarter as meaning that the interest is payable at the quarterly rest. Hence, we are of the view that in Clause 3 of Ex. P. 2 though the words "quarterly rest" have not been used but it is clear from the contents of Clause 3 that the interest is payable at the end of each quarter; in other words, it is payable with quarterly rest. . . . The effect of Clauses 3 and 4 as indicated above would be to permit the Bank to claim interest with quarterly rest".

(emphasis supplied)

20. The first ground is that RBI has permitted Commercial Banks to charge interest with quarterly rests, vide Circular No. DIR.BC. 30/C/96/76, dated 13-3-1976. But, the said circular dated 13-3-1976 is only enabling. In fact, a subsequent circular (CPC No. BC 27/C, 279A-77), dated 12-12-1977, directed as follows:

"As you are aware, Banks are already required to collect interest on agricultural advances at the time of repayment of loan and to avoid compounding of interest charges on current dues. . . . This practice should also apply to the loans to small farmer"s and to the term loans to small-scale industries and others specified in para 7".

The RBI circular dated 12-12-1977 thus made it clear that the Banks should avoid charging of compound interest in respect of term loans granted to small-scale industries. The loan with which are concerned is a term loan advanced to a small-scale industry. We have referred to the said circular dated 12-12-1977, only to show that there is no presumption that RBI has permitted Banks to

charge compound interest in all kinds of lending. There are several types of loans in respect of which the Banks may not or should not charge compound interest. Therefore, the RBI circular permitting levy of compound interest, cannot be construed as a direction to levy compound interest, even where the contract does not provide for compound interest.

21. The second ground is that there is an universal custom of bankers to charge compound interest and therefore they are entitled to charge compound interest with quarterly rests. The English Courts had no doubt recognised the universal custom of bankers to charge simple interest at a reasonable rate on all overdrafts. They have also held that compound interest can only be justified in regard to such overdrafts, in the absence of express agreement, where the customer is shown or must be taken to have acquiesced in the account being kept on that basis (vide Halsbury's Laws of England, 4th Edition, Volume 3 (page 118, para 160). The said principle relating to overdraft, when there is no specific contract governing interest, cannot obviously be extended to term loans where there is a specific contract as to how and at what rate (simple) interest and overdue interest should be charged.

21.1 In D.S. Gowda's case, supra, the Supreme Court clarified the position thus:

". . . as under common law there was no right to charge even simple interest on overdrafts, the claim for interest had to be supported on the ground of universal custom of bankers or on the basis of implied agreement. This would be so in a case where there is no agreement between the banker and the customer in regard to the payment of interest but where the loan or advance is made on certain terms reduced to writing, the parties would be governed by those terms and there would be no question of falling back on practice or custom".

(emphasis supplied)

21.2 In Ravindra's case, supra, the Supreme Court held:

"A creditor can charge interest from his debtor on periodical rests and also capitalise the same so as to make it a part of the principal. Such a course can be justified by stipulation in a contract voluntarily entered into between the parties or by a practice or usage well-established in the world to which the parties belong. Such practice is to be found already in vogue in the field of banking business. Such contract or usage or practice can stand abrogated by legislation such as Usury Laws or Debt Relief Laws and so on. . . The prevalence of banking practice legitimize stipulations as to interest on periodical rests and their capitalisation being incorporated in contracts. Such stipulations incorporated in contracts voluntarily entered into and binding on the parties shall govern the substantive rights and obligations of the parties as to recovery and payment of interest".

Thus usage or practice can be relied on for the purpose of levy of compound interest only when there is no express contract, as in the case of a temporary

overdraft. The question of pleading a custom or practice does not arise, when the matter is covered by express contract.

22. The third ground is that if the Bank regularly debited the interest at the end of every quarter to the borrowers account and capitalised such interest and the borrower did not protest or object to such a course, the Bank is entitled to charge compound interest on the principle of acquiescence. Though such a contention was accepted in Jayakunvar Manilal Shah's case, supra, the subsequent decisions of the Supreme Court have negated such contention.

22.1 In D.S. Gowda's case, supra, the Supreme Court cited with approval, the following passage from Halsbury's Laws of England, 4th Edition, Volume 3, page 118, para 160:

"An unusual rate of interest, interest with periodical rests, or compound interest can only be justified, in the absence of express agreement, where the customer is shown or must be taken to have acquiesced in the account being kept on that basis. Whether such acquiescence can be assumed from his failure to protest at an interest entry in his statement of account is doubtful".

(emphasis supplied) After citing the said passage, the Supreme Court held:

". . . So also charging of interest with periodical rests or compounding of interest would be allowed, if there is evidence of the customer having acquiesced therein, provided the relation of banker and customer is subsisting. However, if the relationship undergoes a change into that of mortgagee and mortgagor by the taking of a mortgage, the charging of interest would be governed in accordance with the terms of the mortgage".

22.2 The matter is now beyond any doubt in view of the Constitution Bench judgment of the Supreme Court in Ravindra's case, supra, wherein it is held:

"Novation, that is, a debtor entering into a fresh agreement with creditor undertaking payment of previously borrowed principal amount coupled with interest by treating the sum total as principal, any contract express or implied and on express acknowledgment of accounts are best evidence of capitalisation. Acquiescence in the method of accounting adopted by the creditor and brought to the knowledge of the debtor may also enable interest being converted into principal. A mere failure to protest is not acquiescence".

(emphasis supplied)

Referring to the contention that borrower not objecting to the entries in statement of account would amount to acquiescence, the Supreme Court observed:

"Penal interest, service charges and other over-heads are debited in the account of the borrower and capitalised of which debits the borrower may not even be aware. If the practice of charging interest on quarterly rests is upheld and given a judicial recognition, unscrupulous Banks may resort to charging interest even

on monthly rests and capitalising the same. Statements of Accounts supplied by Banks to borrowers many a times do not contain particulars or details of debit entries and when written in hand are worse than medical prescriptions putting to test the eyes and wits of the borrowers. Instances of unscrupulous, unfair and unhealthy dealings can be multiplied though they cannot be generalised. Suffice it to observe that such issues shall have to be left open to be adjudicated upon in appropriate cases as and when actually arising for decision and we cannot venture into laying down law on such issues as do not arise for determination before us".

Therefore mere failure to protest by the borrower is not acquiescence. It is not the case of the Bank that the terms of the contract in writing (Ex, P. 8) was altered by any fresh contract and such novation is acquiesced by the borrowers, Therefore plea of acquiescence is not available to the Bank.

23. We may also, in this context, refer to the decision of the Supreme Court in N.M. Veerappa Vs. Canara Bank and Others, , wherein the Supreme Court held that grant of interest in mortgage suits will be governed by the special provisions of Order 34, Rule 11 of the CPC and not by Section 34 of the CPC. It was further held neither Section 21A of the Banking (Regulation) Act, 1949 nor Section 34 of the CPC will override Order 34, Rule 11 of the CPC, which applies to all mortgage suits, including those by Banks; and that grant of interest during the pendency of mortgage suits is in the discretion of the Court.

24. The interpretation of Clause 3 of the term loan agreement (Ex. P. 8) by the Division Bench in Manilal Shah's case, supra, that it authorises changing of interest with quarterly rests, can no longer hold good in view of the subsequent decisions of the Supreme Court in Ganjam District Tractor Owners "Association"s case, supra; D.S. Gowda's case, supra; N.M. Veerappa's case, supra and Ravindra's case, supra.

25. Learned Counsel for the plaintiff-Bank next contended that even if the words "interest with quarterly rests" or "compound interest" were not used in the agreement, as Clause 3 of the agreement provided that interest was payable at the end of every quarter, it would mean that at the end of the quarter, interest could be debited to the account and thereby converted into part of the principal, A provision that interest should be paid once in three months, cannot be construed as meaning payment of compound interest with quarterly rests. If the intention of the Bank was to charge compound interest, the agreement could have provided that compound interest would be charged, or that interest was payable with quarterly rests or that if the interest was not paid at the end of each quarter, the same would be debited to the account and the interest so debited would form part of principal for calculating the interest for the subsequent quarters. In the absence of any provision enabling or authorising of charging of compound interest, we have to reject the contention of the Bank that they are entitled to charge compound interest. A contract to pay interest once in a quarter is not a contract to pay interest with quarterly rests. We accordingly

hold that the Bank is entitled to only simple interest at the rates mentioned in para 16 above.

Re: Point (c),--

26. The next question is whether the plaintiff-Bank is entitled to overdue interest in the event of default of the borrowers, to pay the agreed instalments or accrued interest, and if so, at what rate. The plaintiff avers that the defendants agreed to pay the overdue interest at 2% p.a. in the event of failure to pay the loan amount or interest on due dates. Clause 4 of the loan agreement (Ex. P, 8), provides that overdue interest shall be at the rate fixed by the Bank for such loans from time to time but does, not specify the rate of interest. The letter of undertaking dated 31-10-1984 executed by the borrower stipulates the rate of overdue interest at 2% per annum. Clause 4 of the Agreement (Ex. P. 8) makes it clear that overdue interest is payable only on the amount overdue, that is the instalments and interest which have become due, but not paid. The RBI circulars also authorise the Bank to charge overdue (penal) interest on the amount overdue at 2%. The last instalment of the loan was advanced on 19-9-1985. No instalments were due thereafter till 31-1-1986. Having regard to the manner in which instalments are due, overdue interest at 2% p.a. could be charged on the amounts overdue (that is instalments of the term loan or the amount of interest payable at the end of the quarter, which became due) after 1-2-1986.

27. The Bank is entitled to overdue interest at 2% on the amount overdue (and not on the entire loan amount). The Supreme Court in Ravindra's case, supra, has held that no interest can be collected on the overdue interest:

"Though interest can be capitalised on the analogy that the interest falling due on the accrued date and remaining unpaid, partakes the character of amount advanced on that date, yet penal interest, which is charged by way of penalty for non-payment, cannot be capitalised. Further interest, i.e., interest on interest, whether simple, compound or penal, cannot be claimed on the amount of penal interest. Penal interest cannot be capitalised. It will be opposed to public policy".

Re: Point (d).--

28. The next question is whether the Bank is entitled to debit the amounts towards insurance premia, credit guarantee commission (CGS fee) valuation charges, xerox charges and lawyers' bills etc. Clause 12 of the loan agreement requires the borrower to keep the hypothecated machinery insured and authorises the Bank to pay the insurance premia if the borrower fails to do so. Therefore, the claim for Rs. 25,100/- (that is Rs. 5,985, Rs. 813, Rs. 6,105, Rs. 6,105 and Rs. 6,092, debited on 10-12-1986, 31-3-1990, 1-2-1991, 4-2-1992 and 5-2-1993) towards the insurance premia is upheld. The debit of valuation charges of Rs. 517/ and debit of notice charges of Rs. 150/- have been upheld by the Trial Court and not challenged by the defendants in the suit. Hence, the same are also upheld. The agreement does not empower or authorise the Bank to debit any other amount to the borrowers' account. Nor has the Bank produced any

document to establish that it has incurred such other expenditure. Therefore, the Bank is not entitled to claim or debit any amount by way of Xerox charges or legal fees.

29. The Bank has credited Credit Guarantee Corporation (CGC) fee periodically to the borrower's account, aggregating to Rs. 63,772.45. Admittedly, the contract between the parties do not provide for payment of any CGC fee by the borrower. The Manager of the Bank in his evidence has stated that though the contract does not provide for the same, on the instructions of higher authorities, CGC fee have been debited to the borrower's account, periodically. The Bank has not established how the amount of CGC fee is arrived at and the basis on which such fee is debited to the account of the borrower. CGC may guarantee the credit facilities given by any Bank and may also indemnify the Bank in respect of such credit facilities granted by the Bank under the provisions of Deposit Insurance and Credit Guarantee Corporation Act, 1961, subject to payment of such fees as may be notified by the CGC with the prior approval of the RBI. But, the said Act does not provide for passing on the liability in regard to such fee to the borrowers. Nor does the contract provides for debiting of any such fee paid by the Bank to Credit Guarantee Corporation. Therefore, debiting of CGC fee to the account of the borrower is unauthorised and cannot be sustained.

Conclusion.--

30. On the basis of our findings on the four questions, we allow this appeal in part, as follows:

(a) The finding of the Trial Court that the Bank has advanced in all a sum of Rs. 6,11,000/-- between 31-10-1984 and 19-9-1985 is affirmed.

(b) The finding that the Bank is entitled to Rs. 25,100/ (towards insurance premia), Rs. 517/- (valuation charges) and Rs. 150/- (notice charges) in all Rs. 25,767/ is also affirmed.

(c) The finding of the Trial Court that the plaintiff-Bank is not entitled to Rs. 63,772.45 towards CGC fee nor any amount towards xerox charges/legal charges is upheld.

(d) The finding of the Trial Court that the borrowers have paid in all a sum of Rs. 9,20,766.82 from time to time towards the loan amount and interest as shown in the statement of account (Ex. P. 14) is upheld.

(e) The finding of the Trial Court that the respondents are liable to pay interest only at a flat rate of 12.5% p.a. from 31-10-1984, is set aside. The Bank is entitled to simple interest on the principal amount and the amounts incurred by the Bank (Rs. 25,767/-) from the date of payment upto 18-7-1998 (the date fixed in the judgment of the Trial Court for payment, that is expiry of a period of six months from the date of judgment of the Trial Court) at the following rates:

----- RBI

PERIOD	RATE	OF	CIRCULAR	INTEREST	DATE	(P.A.)

(31-10-1984 to 31-3-1987)	12.5%	31-03-1987	01-04-1987	to 09-10-1988		
12.5%	08-10-1988	10-10-1988	to 21-09-1990	12.5%	21-09-1990	22-09-1990
to 12-04-1991	18%	12-04-1991	13-04-1991	to 03-07-1991	19%	04-07-1991
04-07-1991	to 08-10-1991	20%	08-10-1991	09-10-1991	to 01-03-1992	
22.25%	29-02-1992	02-03-1992	to 08-10-1992	21.25%	08-10-1992	
09-10-1992	to 29-02-1993	21.25%	27-02-1993	01-03-1993	to 23-06-1993	
20.25%	23-06-1993	24-06-1993	to 01-09-1993	19.25%	01-09-1993	From
02-09-1993						18.25%

(f) The Bank shall also be entitled to overdue interest at the rate of 2% p.a. on the amounts overdue, from 1-2-1986 till 18-7-1998 (the date fixed for payment as per the judgment of the Trial Court).

(g) The Bank is not entitled to compound interest or interest with quarterly rests.

(h) The Bank and the borrowers are directed to file a calculation memo (statement of account) showing the amount advanced, simple interest accrued thereon after giving credit to the payments made from time to time (such payment being first adjusted towards interest and other charges like insurance premia and balance against principal), showing the amount due as on 18-7-1998 within three weeks from today.

(i) The Bank will be entitled to interest at the rate of 12% p.a. from 18-7-1998 (the date fixed for payment in the preliminary decree) till date of realisation, on the amount due.

(j) Bank will be entitled to proportionate costs.

The preliminary decree granted by the Trial Court shall be modified as above.

List on 18-6-2004 for filing of the memo of calculations and determination of the amount due.